Department of Finance and Administration

For the Year Ended
June 30, 1998

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Director

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Bonnie Pauly
Staff Auditors

June 23, 1999

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable John Ferguson, Commissioner
Department of Finance and Administration
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Finance and Administration for the year ended June 30, 1998.

We conducted our audit in accordance with generally accepted government auditing standards. These standards require that we obtain an understanding of management controls relevant to the audit and that we design the audit to provide reasonable assurance of the Department of Finance and Administration's compliance with the provisions of laws, regulations, contracts, and grants significant to the audit. Management of the Department of Finance and Administration is responsible for establishing and maintaining the internal control structure and for complying with applicable laws and regulations.

Our audit disclosed certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. The department's administration has responded to the audit findings; we have included the responses following each finding. We will follow up the audit to examine the application of the procedures instituted because of the audit findings.

We have reported other less significant matters involving the department's internal controls and/or instances of noncompliance to the Department of Finance and Administration's management in a separate letter.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/rm
98/108

State of Tennessee

A u d i t   H i g h l i g h t s

Comptroller of the Treasury   Division of State Audit

Financial and Compliance Audit

Department of Finance and Administration

For the Year Ended June 30, 1998

AUDIT SCOPE

We have audited the Department of Finance and Administration for the period July 1, 1997, through June 30, 1998. Our audit scope included those areas material to the Tennessee Comprehensive Annual Financial Report for the year ended June 30, 1998, and the Tennessee Single Audit Report for the same period. These areas included the statewide controls administered by the Department of Finance and Administration and other state agencies. In addition to those areas, our primary focus was on management's controls and compliance with policies, procedures, laws, and regulations in the areas of department employees' access to the state's computer systems, internal auditing activities, equipment records and billing at the Office for Information Resources, the Budget Division, billing procedures in the Division of Resource Development and Support, State Building Commission contracts and departmental contracts, the Division of Real Property Management and Capital Project Management, contingent revenue, Arlington Developmental Center, and Clover Bottom Developmental Center, and utilization of the Department of Finance and Administration's STARS grant module to record the receipt and expenditure of federal funds. The audit was conducted in accordance with generally accepted government auditing standards.

AUDIT FINDINGS

The Tennessee Insurance System and the State of Tennessee Accounting and Reporting System Do Not Reconcile **

Daily activity recorded in the Tennessee Insurance System (TIS) does not agree with the corresponding State of Tennessee Accounting and Reporting System (STARS) accounting transactions, nor can it be reconciled (page 5).

Duties of employees performing statewide payroll functions are not adequately segregated
Duties of employees performing statewide payroll functions in the Division of Accounts are not adequately segregated. One employee is responsible for normal payroll processing, error corrections, security administration, and has access to the actual payroll checks (page 8).

Signature authorization procedures are not adequate
The Division of Accounts has not maintained complete and accurate signature authorization forms for each state department. The Division has not ensured that signature authorization forms are received and updated by the departments when necessary and at the beginning of each fiscal year. In addition, the Division has accepted improperly completed forms from the departments (page 9).

Access to the State Employee Information System Has Not Been Regularly Reviewed
The Division of Accounts statewide payroll section has not regularly reviewed access to the State Employee Information System (SEIS). Because security access has not been periodically reviewed, many unused SEIS User IDs were noted (page 11).

The Division of Accounts' internal Post-Audit review process needs improvement
The Division has no written policies or procedures over the Post-Audit process that state how often they plan to perform periodic reviews. There were sixteen departments in Post-Audit status as of July 1998. However, only one had a Post-Audit report issued during the 1998 fiscal year and two other departments had reports in progress at that time. Although recent sample testwork had been performed on the other thirteen departments, no reports were in progress or had been issued (page 13).

All STARS Program Changes Were Not Properly Approved
Two of 10 State of Tennessee Accounting and Reporting System (STARS) program changes made (20%) did not have proper management authorization or approval (page 14).

Department employees' access to the state's computer systems was not adequately controlled
The department did not promptly cancel terminated employees' access to the state's computer accounting systems or the state's mainframe computer. Persons who were no longer employees of the department still had access to STARS, the State Employee Information System (SEIS), and the Property of the State of Tennessee (POST) (page 15).

Office for Information Resources procedures for billing for dedicated equipment are inadequate
OIR has not been reviewing the cost versus recovery information for the dedicated equipment billings which has allowed agencies to be billed in excess of costs for dedicated equipment. Of the 134 dedicated equipment cost centers reviewed, 34 (25%) had billings that resulted in over- or underbillings (page 17).

Inventory tagging and billing procedures in the Office for Information Resources were not adequate
Office for Information Resources' (OIR) equipment was surplused during the fiscal year but not promptly taken off the inventory records (page 17).

The Office of Internal Audit does not adequately monitor the various divisions within the department
The Office of Internal Audit has not fulfilled its responsibility to continually test the department's internal controls, perhaps partly due to a lack of personnel. During the past fiscal year, internal audit issued 43 memoranda. However, only one memorandum involved testing performed on the department's internal controls (page 19).

The Division of Resource Development and Support's policies and procedures over monitoring agreements needs improvement
RDS did not comply with the state's contracting procedures. Monitoring agreements were not approved before the start of the agreement. All subcontractors were not monitored. A monitoring agreement did not cover all of the procedures that should be followed (page 21).

The Department has not complied with important aspects of the state's grants accounting policy
Grant awards were not entered into the grant control module timely. Drawdowns were not made timely. Status reports to the Federal government contained erroneous information. Indirect costs were not recovered (page 25).

The Department has not complied with Executive Orders 9 and 10 *
The Department of Finance and Administration has not fully complied with two executive orders concerning the state's developmental centers (page 27).

Recordkeeping and security for equipment are inadequate
Clover Bottom Developmental Center (CBDC) does not have adequate controls over equipment, does not maintain accurate property records, and has failed to comply with several State of Tennessee and CBDC policies and procedures regarding property and equipment (page 30).

Internal controls over inventory were inadequate
Clover Bottom Developmental Center did not properly segregate the duties of ordering, receiving, and updating supply inventory records (page 33).

Fiscal Controls at Clover Bottom and Arlington Developmental Centers were inadequate
Clover Bottom Developmental Center did not properly segregate the duties of cash receipting, depositing of cash receipts, and posting to the ledger accounts. Arlington had persons with access to the State of Tennessee Accounting and Reporting System (STARS) who were no longer employees and persons with access to the State Employee Information System (SEIS) who had duties which did not require this access (page 34).

* This finding is repeated from the prior audit.
** This finding is repeated from two prior audits

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

Comptroller of the Treasury, Division of State Audit
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(615) 741-3697

Audit Report
Department of Finance and Administration
For the Year Ended June 30, 1998

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For the Year Ended June 30, 1998

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Department of Finance and Administration. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to "perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller."

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The mission of the Department of the Department of Finance and Administration is to provide financial and administrative support services for all facets of state government. The business, finance, and managerial functions of state government are centralized here; the department prepares and executes the state budget, accounts for state revenues and expenditures, operates a central data processing center, plans and reviews construction and alteration of state buildings, and controls state-owned and—leased property.

The Department of Finance and Administration contains seven divisions: Budget, Administration, Accounts, Office for Information Resources, Insurance Administration, Resource Development and Support, and Capital Projects/Real Property Management.

Executive Order 9 transferred the management and operations of Arlington Developmental Center and the West Tennessee Office of Community Services to the Department of Finance and Administration effective February 7, 1996. In addition, Executive Order 10 transferred the management and operation of Arlington, Cloverbottom, Greene Valley, and Nat T. Winston Developmental Centers and the Middle and East Tennessee Offices of Community Services to the Department of Finance and Administration effective October 14, 1996. Included in this transfer was the Central Office Programmatic and Administrative Support within the Division of Mental Retardation.

An organization chart of the department is on the following page.

AUDIT SCOPE

We have audited the Department of Finance and Administration for the period July 1, 1997, through June 30, 1998. Our audit scope included those areas material to the Tennessee Comprehensive Annual Financial Report for the year ended June 30, 1998, and to the Tennessee Single Audit Report for the same period. These areas included the statewide controls administered by the Department of Finance and Administration and other state agencies. In addition to those areas, our primary focus was on management's controls and compliance with policies, procedures, laws, and regulations in the areas of department employees' access to the state's computer systems, internal audit activities, equipment records and billing at the Office for Information Resources (OIR), the Budget Division, billing methods in the Division of Resource Development and Support, State Building Commission contracts and departmental contracts, the Division of Real Property Management and Capital Project Management, contingent revenue, Developmental Centers and Offices of Community Services**,** and utilization of the Department of Finance and Administration's STARS grant module to record the receipt and expenditure of federal funds. The audit was conducted in accordance with generally accepted government auditing standards.

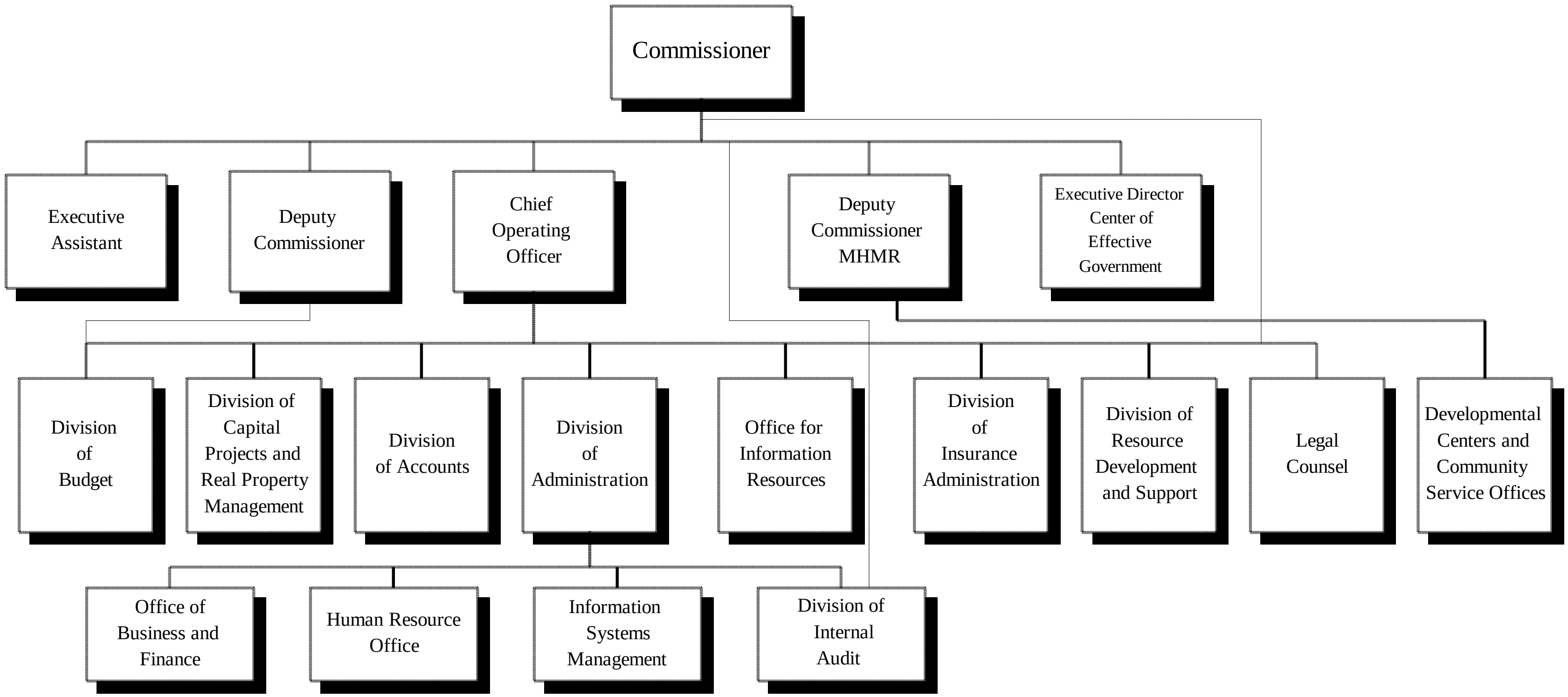
OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

AREAS RELATED TO TENNESSEE'S COMPREHENSIVE ANNUAL FINANCIAL REPORT AND SINGLE AUDIT REPORT

Our audit of the Department of Finance and Administration is an integral part of our annual audit of the Comprehensive Annual Financial Report (CAFR). The objective of the audit of the CAFR is to render an opinion on the State of Tennessee's general-purpose financial statements. As part of our audit of the CAFR, we are required to gain an understanding of the state's internal controls and determine whether the state complied with laws and regulations that have a material effect on the state's general-purpose financial statements.

The Department of Finance and Administration is responsible for maintaining the state's central accounting system and preparing the CAFR. The department, in conjunction with other state agencies, provides centralized statewide controls in the following areas:

Department of Finance and Administration



Note: Dotted line indicates to whom a division reports for business matters if it is different from administrative matters

- Statewide accounting system
- Budgets and appropriations
- Cash receipts and disbursements
- Payroll transaction processing
- Fixed asset records

As part of our audit of the CAFR we reviewed selected controls over these areas in the Department of Finance and Administration and other state agencies.

To address our statewide audit objectives, we interviewed key department employees; reviewed applicable policies and procedures; examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements; performed analytical procedures, as appropriate, assessed the accounting principles used and significant estimates made by management; and evaluated the overall financial statement presentation. Our testing focused on the propriety of financial statement presentation, the adequacy of internal controls, and compliance with applicable finance-related laws and regulations.

Our audit of the Department of Finance and Administration is also an integral part of the Tennessee Single Audit which is conducted in accordance with the Single Audit Act of 1984, as amended by the Single Audit Act Amendments of 1996. The Single Audit Act requires us to determine whether

- the state complied with rules and regulations that may have a material effect on each major federal financial assistance program, and
- the state has internal accounting and administrative control systems to provide reasonable assurance that it is managing federal financial assistance programs in compliance with applicable laws and regulations.

We determined that on June 30, 1998, the Department of Finance and Administration had no federal programs which were material to the CAFR and to the Single Audit Report.

We have audited the general-purpose financial statements of the State of Tennessee for the year ended June 30, 1998, and have issued our report thereon dated January 25, 1999. The opinion on the financial statements is qualified. Because of the unprecedented nature of the Year-2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the Year-2000 and thereafter. The Tennessee Single Audit Report for the year ended June 30, 1998, will include our reports on the schedule of expenditures of federal awards and on internal control and compliance with laws and regulations.

As a result of our work, we determined that the department had:

- significant problems with the Tennessee Insurance System,
- inadequate segregation of duties over statewide payroll,

- inadequate signature authorization procedures,
- weak post audit review process,
- unapproved program changes,
- inadequately controlled access to computer accounting systems, and
- inadequate inventory tagging and billing procedures in the Office for Information Resources.

These problems are discussed in findings 1 through 9. In addition, minor weaknesses came to our attention which have been reported to management in a separate letter.

1. The Tennessee Insurance System has significant problems which have caused TIS and STARS not to reconcile

Finding

As noted in two prior audits, the Tennessee Insurance System (TIS) has not been designed, implemented, and maintained in a manner which allows it to function efficiently and effectively. As a result, the system is not producing the desired results and changes are being made directly to the TIS database through the Application Development Facility (ADF). Because these changes are not being made to the insurance accounting on the State of Tennessee Accounting and Reporting System (STARS), TIS and STARS do not reconcile. Management responded to the prior audit finding and stated that the Division of Insurance:

- had transferred the duties of balancing TIS to STARS from the Division of Accounts to the Division of Insurance,
- had established three work groups to address reengineering the information systems and focus on balancing TIS to STARS,
- had developed a priority list for TIS enhancements, which is reviewed and updated weekly instead of monthly and included high priority items on the Department of Finance and Administration's Annual System Plan, and
- was monitoring and tracking changes made through the Application Development Facility (ADF) for the purpose of reducing the number to zero. In March 1998, the division moved into production a COBRA 18th month eligibility programming change that would eliminate five to ten ADF changes per month,
- was evaluating several options to improve the process for correcting the TIS database including a change in the base design and language of TIS. Also, the division was evaluating custom programs, which would allow TIS to be corrected via appropriate updates leaving appropriate audit trails.

Management also stated that due to the complexities of the systems involved, they did not expect that the actions described above would resolve all reconciliation problems within the next twelve months. However, they stated they were committed to providing both immediate and long-term resources required to implement corrective action.

The first four items mentioned appear to have been done by management while the fifth one appears to be in process. Although management has taken four of the five steps indicated in their prior comments, the same basic problems with TIS were still noted in the current audit.

Because of the many problems with TIS, numerous program changes are needed. Program change requests are maintained on a System Information Request Log (SIRLOG), which shows the system problem, date of change request, and priority of the item. As these problems are researched and corrected through program changes or other measures, they are cleared from the log. However, the current year log included 4 of 19 items (21%) carried over from the prior year.

Furthermore, the division is still using Application Development Facility (ADF), a software program, to manually adjust participants' accounts on TIS. These adjustments to participants' accounts are made directly in the TIS database rather than through transactions, an approach the Division of Insurance Administration (DIA) called "going through the back door" of the system. The system's security must be overridden in order for an ADF change to be made. The division sends a request for the ADF change to the department's Information Systems Management (ISM) group, which in turn submits a request to the Office for Information Resources (OIR). OIR assigns one of its employees to make the ADF changes on the TIS database. As noted in the prior audit, overriding system security to make manual adjustments is a significant deficiency in the design and operation of the system.

The Division of Insurance Administration uses ADF as a "quick fix" to correct participant balances or errors attributable to unresolved system problems. Although division staff maintain paper documentation of the ADF changes, the system has no history or record of the changes because they simply overwrite previous information in the database. If the system had been designed and was functioning properly, use of ADF would not be necessary. As previously noted, making changes directly to a database instead of correcting errors through properly authorized and documented transactions circumvents system controls.

In addition, when the TIS database is corrected using ADF, STARS is not updated concurrently. As a result, the two systems do not agree, nor can they be completely reconciled. Management concurred with the prior finding, stating that new procedures were being implemented but would not resolve all the reconciliation problems within the next twelve months. A new employee was hired in September 1997 to work on the reconciliation problem. This employee has been tracking the unreconciled amounts and reports to the TIS system information staff and is a part of a work group that was established to focus on the reconciliation issue. This work group has reviewed the TIS program change request log and changed the priority of the issues on the log. In addition, the department has included TIS issues in its three year reengineering plan. These steps should help the department address the problems with TIS;

however, TIS and STARS still do not reconcile. The auditors noted unreconciled amounts between the net change in the TIS database and the cumulative accounting transactions passed from TIS to STARS daily during fiscal year 1998 ranged from $79.00 to $84,676.41, with an average unreconciled amount of $32,099.17 for the twenty days reviewed.

"Certification" of insurance is an example of an accounting transaction that caused reconciliation problems. Certification occurs at month-end when employees' insurance premiums collected during the month are moved from the deferred revenue account into the revenue account. Funds that cannot be identified are considered "uncertified" amounts. We attempted to reconcile total collections according to TIS, taking into consideration the uncertified amounts, with revenue recorded in STARS. The result was a $43,376.71 unexplained difference. In addition, management noted on the July 15, 1998, System Information Request Log that collections applied and collections certified were out of balance as much as $200,000 to $400,000 per month.

Departmental memorandums state that the TIS database is correct but the accounting information on STARS is incorrect. Although STARS has been corrected to the extent possible, there can be no assurance all needed corrections have been made since not all ADF changes made to TIS were made on STARS and TIS does not maintain history records of all past transactions. We performed analytical reviews and other measures at year-end to ensure the insurance funds' financial statements presented in the state's Comprehensive Annual Financial Report were fairly stated. These additional procedures would not have been necessary had all TIS activity been properly reflected on STARS.

Recommendation

The Commissioner should require the Director of Insurance Administration to develop plans of action to ensure that all TIS system problems are corrected as soon as possible. The Director of Insurance Administration should ensure that the work group makes timely changes to correct the many TIS problems. Old items on the Systems Information Request Log (SIRLOG) should be corrected and cleared from the log. As the system problems are corrected, the use of ADF changes should be minimized and, if possible, eventually eliminated. Until that time, STARS should be concurrently updated as ADF changes are made to TIS. In addition, the work group should continue to meet until all the problems causing the unreconciled amounts are resolved and TIS and STARS can be reconciled. As problems arise in the future, causes of the problems should be quickly identified and TIS should be corrected through program changes or other appropriate means.

Management's Comment

We concur. As noted in the finding, the department is committed to resolving the problems with TIS. Also, as noted, there are no quick fixes for the system problems. Through on-going maintenance we have resolved or minimized some of the issues and we are prepared to begin a major re-engineering effort of the system in FY 2000. Management will closely monitor the progress and the projected completion date.

2. Duties of employees performing statewide payroll functions are not adequately segregated

Finding

Duties of employees performing statewide payroll functions in the Division of Accounts are not adequately segregated. One employee's responsibilities include processing and approving payroll transactions through the State Employee Information System (SEIS) and the Data Capture System (DCS) systems, correcting payroll processing errors, and monitoring the issuance of payroll checks. The employee also serves as the Security Administrator for both SEIS and DCS, giving this employee access to the security settings in the systems, which provide for many of the system controls. Effective internal controls over any accounting process require duties to be adequately segregated. One employee should not be responsible for normal payroll processing, error corrections, security administration, and have access to the actual payroll checks.

While there have been no known irregularities associated with the lack of segregation of duties, the situation allows possible errors and irregularities to occur and go undetected in a timely manner by employees in the normal course of performing their duties.

This same individual is the only employee who has a comprehensive understanding of the entire payroll process. Other employees rely heavily on this employee to help them correct payroll-related problems. When only one employee has full knowledge of an accounting process, other employees may be so dependent on this employee that the division would face a major crisis if the knowledgeable employee was suddenly unavailable.

Recommendation

The Director of Payroll should re-evaluate the processes and job duties of each employee in the statewide payroll section and develop a plan to ensure employees are not assigned incompatible duties creating situations that allow for misappropriation of assets. Job assignments should be re-evaluated on a periodic basis as changes in circumstances, conditions, and computer systems occur.

Management's Comment

We concur. Many compensating controls exist to ensure appropriate processing of payroll transactions. These controls include departmental initiation and approval of transactions, Department of Personnel approval and finally Payroll management review. Even though there have been no known irregularities, the Payroll management is currently re-evaluating the processes and job duties of each employee. A plan is being developed by Payroll management to ensure employees are not assigned incompatible duties.

3. Signature Authorization Procedures Are Not Adequate

Finding

The Division of Accounts has not maintained complete and accurate signature authorization forms for each state department. Each state agency is required to submit a signature authorization form covering each of its allotment codes. The form documents the signatures of employees authorized to sign for the department head and budget/fiscal officer. Division of Accounts' employees use these forms to ensure transactions are properly approved before they are processed for payment.

The most recent Division of Accounts memorandum requesting signature authorization forms from each department stated:

> The upper right corner section of the signature authorization form identifies the administering agency allotment code and the agency division codes covered by the authorization form. These codes are important and should be completed carefully to insure only those authorized personnel are allowed to sign the appropriate accounting documents in each division.
>
> Complete a new signature authorization form at the beginning of each fiscal year for all personnel authorized to sign the fiscal officer and department head signatures on all accounting documents. …The original signatures of the fiscal officer and the department head must appear in the designated space at the bottom of the signature authorization form to validate the authorized signatures. …If changes occur in those personnel authorized to sign for the fiscal officer or the department head during the year, complete a new signature authorization form to replace the existing form on file in the [Division of Accounts].

The Division of Accounts has not ensured that signature authorization forms are received and updated by the departments when necessary. The Division of Accounts has not required each department to submit new forms at the beginning of each fiscal year. In addition, the Division has accepted improperly completed forms from the departments.

A review of 104 signature authorization forms on file was performed and the following errors were noted:

- Forty-three forms (41%) were not signed by the actual department head. Forty-one of the forms had a name other than the name of the department head in the designated space on the form and two of the forms were signed by a designee and initialed.
- Forty-two forms (40%) were not completed correctly. For example, people authorized to sign for the department head and fiscal/budget officer were to show their signature of the department head and/or fiscal/budget officer with their initials. However, they would sign their own name or they would sign a name of someone other than the department head or fiscal/budget officer.
- Thirty-six forms (35%) had a name other than the name of the actual budget/fiscal officer in the designated space on the form.

In addition, nine of 50 supplemental payroll transactions exceeding $10,000 (18%) were processed by the statewide Payroll Division, but were not properly approved at the departments. They were signed by an employee without authorization to sign for the department head. Also, eight of these 50 payroll transactions (16%) were not properly approved by the budget/fiscal officer in accordance with the signature authorization form. The payroll officer approved the transactions. The Division of Accounts does not require a different signature authorization form for payroll transactions, but uses the same form used for other fiscal transactions.

Furthermore, the department has not adequately administered the signature authorization process in relation to the Department of Mental Health and Mental Retardation (DMHMR). Signature authorization forms for the state's developmental centers still showed DMHMR officials as the department head and budget/fiscal officer. However, the developmental centers were moved by executive order from DMHMR to the Department of Finance and Administration on February 17, 1996, (Executive Order 9-Arlington) and October 14, 1996 (Executive Order 10-all others). In addition, the Division of Accounts has allowed forms for the developmental centers, the mental health institutes, and the correctional facilities to vary from the regular format. The Division has allowed the facility superintendents and facility fiscal officers to sign as the actual department head and fiscal officer.

Neither the Commissioner of Finance and Administration nor the budget/fiscal officer signed the Department of Finance and Administration's signature authorization forms for the Insurance Administration Division. The Division of Accounts authorization forms were not signed by the Commissioner of Finance and Administration. In addition, the designated employees did not always sign the name of the department head or fiscal director with their initials, but instead signed either their own names or another department employee's name for the department head.

Current signature authorization forms have not been maintained and used properly by the Division of Accounts. Although each department may have submitted a correct form at one time, many forms were no longer current because some of the employees listed had either changed positions or departments, or even terminated their employment with state government. Twenty-four of 52 agencies (46.2%) have one or more forms that have not been updated in more than one year.

Without using current and correct signature authorization forms, the Division of Accounts cannot ensure all transactions are being properly approved at the departments before they are sent to Accounts for processing.

Recommendation

The Division of Accounts should implement controls to ensure properly completed signature authorization forms are submitted at least annually for each department before processing a department's transactions. Management should also consider whether to require separate forms for payroll transactions since these transactions need to be approved by the payroll officer instead of the fiscal/budget officer.

Management's Comment

We concur. The Division of Accounts is currently revising the authorization form in ways to make it simpler for the preparer to complete and easier to understand management's intent. The Division of Accounts requested updated authorization forms during each annual accounting meeting except for the 1998 meeting. The reason the forms were not addressed at the 1998 meeting was because the auditors had raised questions about the content of the forms. The signature authorization form is not regulation nor is it state law. No commissioner or agency head can shirk his/her ultimate responsibility for the business conducted within his/her department. Departmental management decides who is authorized to sign forms that ultimately result in accounting transactions. Division of Accounts' concern is that the paperwork be completed and reviewed by a person who is knowledgeable about the transaction and related accounting classification information so that it can process an approved, accurate transaction. Upon revising the form, the Division of Accounts will establish another routine method for renewing the forms' information to more clearly reflect management's intent.

4. Access to the State Employee Information System Has Not Been Regularly Reviewed

Finding

The Division of Accounts statewide payroll section has not regularly reviewed access to the State Employee Information System (SEIS). Like other internal controls, access controls should be evaluated regularly to ensure they are still effective. Personnel and departmental changes can impact the effectiveness of these controls. Good security controls require access to systems to be limited to a "need-to-know, need-to-do" basis. Because security access has not been periodically reviewed, unused SEIS User IDs were noted. Of the 902 SEIS users as of August 8, 1998,

- 174 users had never signed on the system;
- 509 users had an active status but had not signed on the system in the last 180 days; and
- 79 users had an “inactive” status, which means that they are in “without pay status.” (System security does not allow “inactive” IDs access to the system.)

The large number of unused User IDs indicates there are individuals with access who do not need it and should no longer have access to the system. Because of the sensitive nature of data in SEIS, limited access is vital.

When the Data Capture System (DCS) was implemented in fiscal year 1996, timekeeping functions were moved from SEIS to DCS. Therefore, many SEIS users no longer needed access to that system. However, neither the Security Administrator nor user management have reviewed the necessity of SEIS users’ security access since DCS’ inception.

Recommendation

Annually, the Division of Accounts should require the departments to review security access for all current User IDs to determine whether the access is still appropriate based on the employee’s current job responsibilities. Appropriate changes should be made based on user management’s recommendations. Departments should be instructed that User IDs and passwords should be revoked for those who no longer need access to SEIS. The Division of Accounts should eliminate all inactive user IDs from the system, even though inactive IDs do not allow access to the system.

Management’s Comment

We do not concur. In our opinion, this is not a material weakness. The Division of Accounts controls access to the SEIS through an authorization process. Departments determine their own user needs based on their administrative control structure. The Division does not have a routine procedure for eliminating inactive user accounts, but one will be established. Inactive accounts have been removed.

Auditor’s Comment

Management appears to be taking the action recommended.

5. The Division of Accounts' internal Post-Audit review process needs improvement

Finding

The Division of Accounts reviews departmental expenditures through either the Post-Audit or Pre-Audit process before releasing batches of data in the State of Tennessee Accounting and Reporting System (STARS). For agencies in Post-Audit status, the Division reviews the department's expenditures to determine whether the documents have been approved by authorized officials of the department and to ensure any corrections requested by the department are made. For agencies in Pre-Audit status, the Division performs a more comprehensive review of the department's expenditures before they are processed.

Agencies may request to be placed in Post-Audit status by the Division of Accounts. The Post-Audit section of the Division then performs a review of the department's internal controls completing an internal control questionnaire, as well as testing a sample of disbursements to determine if the department has properly processed and accounted for its transactions.

For departments that are placed in Post-Audit status, the Division states they perform periodic reviews to ensure the department should remain in Post-Audit status or whether it should be returned to Pre-Audit status. However, the Division has no written policies or procedures over the Post-Audit process that state how often they plan to perform periodic reviews.

There were sixteen departments in Post-Audit status as of July 1998. However, only one had a Post-Audit report issued during the 1998 fiscal year and two other departments had reports in progress at that time. Although recent sample testwork had been performed on the other thirteen departments, no reports were in progress or had been issued. The report is the method used by the Division of Accounts to document their decision regarding a department's Post-Audit status.

One department was notified in March 1993 that they would remain in Post-Audit status, but the department needed to improve their disbursement process and correct the signature authorization and segregation of duties problems. In July 1996, the Division of Accounts performed another Post-Audit review of this department. The Division of Accounts found many of the same problems that were noted in the 1993 review. However, the department was allowed to remain in Post-Audit status and told that another review would be performed in September 1996. The Division of Accounts told the department they would need to make significant improvements to remain in Post-audit status after the September review. The Division of Accounts did not perform the review until July 1998 and the report for this review was not available at the time of the audit.

When a department is in Post-Audit status, their expenditures are not subject to the same controls as the agencies in Pre-Audit status. If the department mentioned above had been on Pre-Audit status, the Division of Accounts may not have processed the documents with many of the errors noted until they were corrected. However, these transactions were processed with the errors because they did not go through the Pre-Audit process. Without timely completion of

Post-Audit reports and proper follow-up of the Post-Audit recommendations, the Division of Accounts has little assurance that transactions for departments in Post-Audit status are being properly processed.

Recommendation

The Division of Accounts should develop written policies and procedures that address how often they plan to perform Post Audit reviews of the departments. In addition, management should prepare timely reports for all Post-Audit reviews performed.

Management's Comment

We concur. The Division has addressed the timeliness of reporting problem strategically by moving some responsibilities to a new section. Timeliness was affected by staff turnover and the resulting difficulty of finding qualified accountants willing to work within our pay scale. The division allocated the remaining resources to critical regulatory compliance issues such as federal 1099 reporting, the state's comprehensive annual financial reporting, and preparation of the schedules of grant activity required by the federal government. The responsibility for accurate and timely processing of accounting entries does not rest solely upon the Division of Accounts. As required by *Tennessee Code Annotated*, Section 9-18-102, each agency must accept responsibility for establishing and maintaining adequate accounting and administrative systems to assure that transactions are being properly processed. Guidelines for the timing of reviews will be established.

6. All STARS Program Changes Were Not Properly Approved

Finding

Two of 10 State of Tennessee Accounting and Reporting System (STARS) program changes made (20%) did not have proper management authorization or approval. These program changes were initiated by staff in the Information Systems Management (ISM) division. Normally, the department uses a program change request to document the change and approval of the request. However, for these two program changes, no request form was completed. The request form requires approval of the test results, as well as endorsement by user management. Since the form was not completed, the approval of the program change was not properly documented.

Without a proper program change approval process, programs could be modified and changed without management's knowledge resulting in a system that does not meet user needs and stated objectives.

Recommendation

The Director of Information Systems Management should ensure all program change requests are initiated only upon written request and approved in writing before program changes are made.

Management's Comment

We concur. We will take the necessary steps to ensure that all program change requests are properly initiated and approved.

7. Department employees' access to the state's computer accounting systems was not adequately controlled

Finding

The department did not promptly cancel terminated employees' access to the state's computer accounting systems or the state's mainframe computer. The state uses the Resource Access Control Facility (RACF) access system to control access to the state's mainframe computer. The RACF access is the first level of security and the accounting system access controls are the second level of control used by the state to protect unauthorized users from accessing the system or its data.

The department had previously terminated employees who still had access to the following systems on June 22, 1998:

- State of Tennessee Accounting and Reporting System (STARS)—22 of the 175 persons listed as having access to STARS (12.6%) were no longer department employees. These persons had been terminated from employment from four days to one and one-half years before their STARS access was revoked. Nine of these 22 users' (41%) RACF access was not revoked until one month or longer after their termination date. Two of these nine employee's access was not terminated as of February 1999.
- State Employee Information System (SEIS)—5 of the 53 persons listed as having access to SEIS (9.4%) were no longer department employees. These persons had been terminated from employment from four to eleven months before their SEIS access was revoked. Although the RACF access for these five users had been terminated, two users' (40%) RACF access was not revoked within one month of their termination date.
- Property of the State of Tennessee (POST)—19 of the 98 persons listed as having access to POST (19.4%) were no longer department employees. These persons had been terminated from employment from one week to two years before their POST access was revoked. Although the RACF access for these 19 users had been revoked,

12 users' (63%) RACF access was not revoked within one month of their termination date.

- Access to the State of Tennessee Accounting and Reporting System (STARS) was not always properly authorized and approved for all Division of Accounts employees. Security authorization forms are used by the Division of Accounts to authorize and document each user's approved access to STARS. However, nine of 42 Division of Accounts employees (21%) did not have the type access authorized on the security authorization form. Five users had access to the error correction screen; two users had access to release transactions; one user had access to release transactions and override funding errors; and one user had access to update the warrant writing table. Failure to assign the access requested and approved could allow some individuals unauthorized access to the system. Because of the responsibilities that Division of Accounts staff have and the amount of information they have access to, the Division needs to be sure that their employees only have the access authorized.

Not promptly canceling RACF access and access to these important accounting systems increases the possibility of unauthorized changes and decreases assurances of the systems' integrity.

Recommendation

The Commissioner should establish a policy requiring employee access to any of the state's computer systems to be evaluated as soon as an employee resigns or is terminated to determine if the access should be immediately revoked or allowed to continue to the last day of work. Each STARS user's access should be properly authorized and approved and the access given should agree to the security authorization form.

Management's Comment

We concur that department employee access to state computer systems should be removed when they leave the employment of the department. Currently, the Human Resource Office is notifying each system security contact when an employee leaves the department in order for access to systems to be removed. Additionally, we have in draft form more formal procedures related to system security. These procedures should be in place by July 1, 1999.

The Division of Accounts has a process in place to authorize access to STARS. In a review of the forms for STARS access by Division of Account's employees, all but three employees had the access that was required of their job. The forms were not correctly completed. These were considered errors and not a procedural weakness.

8. <u>Office for Information Resources procedures for billing for dedicated equipment are inadequate</u>

Finding

The Office for Information Resources (OIR) provides computer and telecommunication services and hardware to state departments and bills agencies for services provided statewide and for dedicated equipment which is for a specific agency's use. The rates charged by OIR for dedicated equipment should cover cost which includes an administrative fee. OIR has not been reviewing the cost versus recovery information for the dedicated equipment billings which has allowed agencies to be billed in excess of costs for dedicated equipment.

Of the 134 dedicated equipment cost centers reviewed, 34 (25%) had billings that resulted in over- or underbillings. Twenty of the cost centers (15%) had overbillings and 14 (10%) had underbillings. A number of these agencies receive federal funding and may have passed these under/overbillings to the federal government.

If billings are not accurate for dedicated equipment, state departments will not pay their proportionate share of the costs. Some would pay too much, while others would not pay enough for specific services and hardware.

Recommendation

The Chief of OIR should establish procedures to ensure revenues for each dedicated equipment cost center are properly matched against expenses.

Management's Comment

We concur. Timely close out for all dedicated equipment cost centers will be completed in the future.

9. Inventory tagging and billing procedures in the Office for Information Resources were not adequate

Finding

Office for Information Resources' (OIR) equipment was surplused during the fiscal year but not promptly taken off the inventory records. OIR used improper tag numbers on this equipment which resulted in computer upgrades and software remaining on the equipment listing after they had been surplused with the upgraded equipment. Also, OIR wrote off additional items that were add-ons to equipment previously surplused. Adjustments were made to the equipment records to correct the balances before the financial statements were prepared.

Much of the equipment OIR purchases is used at other departments which pay OIR for the use of the equipment. When a department no longer needs a piece of equipment, it submits a

Request for Service (RFS) instructing OIR to pick up the equipment and stop the billing. A review of RFSs disclosed the following weaknesses:

a. For 18 of 25 RFSs tested (72%), OIR billed agencies for more than 30 days after equipment was removed from the agencies by OIR personnel. The billings continued for 48 days to approximately 12 months.

b. For 20 of 25 RFSs tested (80%), the Property of the State of Tennessee (POST) system had not been updated within 30 days to indicate changes in the equipment's location. The delays ranged from 41 days to approximately 15 months.

When proper equipment records are not maintained, the probability increases that equipment will be lost or stolen and not be detected. If proper follow-up is not made when an RFS is completed, leasing agencies will be improperly charged for equipment they no longer have.

Recommendation

The Assistant Commissioner of Administration should ensure that appropriate inventory procedures are established and communicated to the agencies which are leasing the equipment, so OIR can make timely changes to the equipment and billing records. This should result in missing equipment being detected more promptly. If a piece of equipment is not found, Internal Audit and the Comptroller's office should be promptly notified; and the records in POST updated. As upgrades and software are added to equipment, POST records should be updated to include information about these add-ons.

The Assistant Commissioner for OIR should ensure that billings for equipment usage are stopped after an RFS is completed and that the records in POST are updated promptly. Each RFS should be tracked to ensure that the property records are updated timely and to ensure that the billings are correct.

Management's Comment

We concur that timely changes should be made to the inventory and billing records. It is the responsibility of F&A's fiscal office to facilitate an annual inventory of all OIR equipment, both internal use and leased. We have improved our inventory process for this fiscal year by providing training on the inventory procedures to OIR and other department's staff that lease equipment from OIR. Currently the number of items inventoried is improved over previous years. We are continuing to pursue items not inventoried with the appropriate departments.

Depending on the type of equipment/service, the appropriate staff from OIR is responsible for completing the RFS which includes updating the billing and inventory system. Department's leasing equipment from OIR are billed monthly for OIR equipment and services. Any billing discrepancies noted by a department will be corrected.

INTERNAL AUDIT

Our objective in reviewing this division was to determine if an adequate amount of auditing was being performed on the internal controls within the various divisions of the department. We attempted to determine if this division was meeting the goal of auditing all principal programs in the department within six years. As a result of this testwork, we had the following finding:

10. <u>The Office of Internal Audit has not adequately monitored the various divisions within the department</u>

Finding

The Office of Internal Audit has not fulfilled its responsibility to continually test the department's internal controls, perhaps partly due to a lack of personnel. The department's budget is more than $488 million and encompasses such principal programs as Office for Information Resources, Division of Budget, Division of Capital Projects and Real Property Management, Division of Accounts, Criminal Justice Programs and the state's mental retardation centers. In addition to the department's processes, the department has statewide responsibilities with regard to the state's finances and general administration. Therefore, the internal audit office has more areas of responsibility than internal audit offices in other departments.

The department's Internal Audit policies and procedures manual states," To the extent resources are available for such purposes, all principal programs...shall be audited and reported on...at least once during each six-year period." During the past fiscal year, internal audit issued 43 memoranda. These memoranda covered such areas as long distance phone calls, missing equipment, year-end inventory, state-wide review of direct purchase authority process, follow-up of weaknesses noted by State Audit, statewide confirmation of departmental bank accounts, etc. However, only one memorandum involved testing performed on the department's internal controls.

During the audit period, the office had a director, two auditors, and two program analysts on staff. The two auditors and the director were performing internal audit reviews, but the program analysts worked primarily on Facilities Revolving Fund projects.

Recommendation

The director should, with the advice and consent of the commissioner, schedule each principal program for audit within the next six years. A sufficient number of internal auditors should be hired to ensure the scheduled internal audits are completed and provision is made for special projects as they arise.

Management's Comment

We concur. As included in the finding, our Internal Audit policies and procedures manual states "To the extent resources are available for such purposes, all principal programs…shall be audited and reported on… at least once during each six-year period." We will continue, within resources available, to schedule all principal programs for an internal audit at least once during each six year period.

The staff allocated to internal audit will be reviewed. However, total state resources that are available are limited and adding additional staff may not be viable at this time.

BUDGET DIVISION

Our objectives in reviewing the Budget Division were to determine whether

- the 1997-1998 appropriation bill would reconcile to the original budget and the final budget on the State of Tennessee Accounting and Reporting System (STARS);
- the budget document contains the information required in Section 9-6-106, *Tennessee Code Annotated*; and
- the appropriation bill contains the information required in Section 9-6-108, *Tennessee Code Annotated*;
- the report on the estimated growth of the state's economy has been reviewed by the State Funding Board and has been properly followed up on,
- the percentage increase in the recommended appropriations from state tax revenues does not exceed the percentage increase in Tennessee personal income for the succeeding fiscal year.

We interviewed key personnel to obtain an understanding of the procedures used. We then obtained the appropriation bill for 1997-1998 and reconciled for a sample of agencies the approved appropriation bill amounts to the original budget that was recorded on STARS. We reviewed *Tennessee Code Annotated* and the budget document and appropriations bill to determine whether they contained the required information. We determined if the State Funding Board has reviewed the report on the estimated rate of growth of the state's economy for the fiscal year ended June 30, 1998, and commented on its reasonableness. We determined if the State Funding Board provided a list of approved state tax revenue sources to the Department of Finance and Administration and if the department provided estimates of revenue from the sources provided by the Board. Using this information we determined if the percentage increase of recommended appropriations from state tax revenues did not exceed the percentage increase of estimated Tennessee personal income for the succeeding fiscal year.

As a result of our work, we had no findings related to this division.

DIVISION OF RESOURCE DEVELOPMENT AND SUPPORT

Our objectives in reviewing the procedures used by this division were to determine whether subrecipients were being properly monitored and whether departments and divisions which use this division to monitor their subrecipients were being properly billed for the service.

We interviewed key personnel and reviewed the procedures that were being used. We reviewed the written agreements with the departments and divisions which use this division to determine the procedures that should have been followed during the monitoring visits and to determine if enough subrecipients were monitored during the fiscal year. We tested a sample of monitoring reports to determine if the reports were complete and properly documented. In addition, we tested a sample of billings to determine if the billings had adequate support and appeared proper.

As a result of this testwork, we drafted the following finding. In addition, other minor weaknesses came to our attention which have been reported to management in a separate letter.

11. The Division of Resource Development and Support's policies and procedures over monitoring agreements needs improvement

Finding

Through agreements with other state departments and two divisions within the department, the Division of Resource Development and Support (RDS) monitors subcontractors for other state agencies and divisions. Deficiencies were noted in several areas

a. RDS did not comply with the state's contracting procedures. The agreements for monitoring services with the Department of Human Services and the Department of Children's Services were written as memoranda of understanding. However, the Office of Contracts Administration's rules and regulations do not address the use of memoranda of understanding. The Office of Contract Administration's rules and regulations only list interdepartmental contracts as the method of contracting between agencies. The absence of rules and regulations or policies and procedures allowing the use of memoranda of understanding indicates they are not an approved method of contracting between agencies.
b. The monitoring agreements were not approved before the start of the agreements. The approval signatures for the agreement with the Office of Criminal Justice (OCJ) were dated four and one-half months after the start of the agreement; however, no

work was started until the agreement was signed. In addition, the agreements with the Department of Children's Services and Human Services were not dated. Contracts should be properly entered into and signed and dated by all parties before the effective date of the contracts to ensure they are properly executed documents.

c. The monitoring agreement with Human Services did not describe specific procedures to be followed by RDS staff during the fiscal monitoring visits performed for Human Services. All contracts whether with another state department or outside party need to clearly state the terms and conditions for both parties. Full disclosure could prevent misunderstandings or unmet obligations on either party's part.

d. Not all subcontractors listed in the agreements were fiscally monitored by RDS staff.

- Two of 11 Human Services subcontractors (9.1%).
- Fifty-five of 110 Office of Criminal Justice fiscal year 1998 subcontracts (50%).

The memorandum with the Office of Criminal Justice states that OCJ is to provide a list of contracts to be reviewed by RDS. This list is Attachment B to the memorandum of understanding and lists the 110 subcontractors. Management stated that it did not intend for all subcontractors referenced in the agreements to be monitored. However, the documents indicate that all or at least most subcontractors would be monitored, but only 50% of the subcontractors were actually monitored for fiscal year 1998.

Recommendation

The commissioner should ensure agreements involving the department and other state departments comply with state contract policies and procedures. All contracts should be signed and dated no later than the effective date of the contract.

Management's Comment

We do not concur. All issues noted in the finding are at best procedural issues. There were no detrimental consequences arising because of the format of the agreement, the date the contract was signed, not specifying fiscal monitoring procedures and not specifying specific contracts to be monitored.

However, in the future the department will use interdepartmental agreements with all state agencies and memorandum of agreement for programs within Finance and Administration (i.e. Office of Criminal Justice, Commission on National and Community Service, etc.). To the extent possible, all agreements will be in place prior to the start date.

Auditor's Comment

Management appears to be taking the action recommended.

CONTRACTS

Our objectives in reviewing the procedures related to contracts were to determine whether

- contracts were properly approved;
- contract payments complied with the terms of the contracts;
- goods and/or services paid for under the terms of these contracts were received before payment was made;
- Building Commission contracts are awarded only to reputable, experienced contractors and;
- Procedures for accumulating the amounts for inclusion in the General Fixed Asset Account Group as construction in progress and completed buildings appeared proper.

We interviewed key personnel about the procedures that were being used and compared these procedures to the applicable laws, regulations, and policies. We tested a sample of building commission contracts, building commission projects, and personal service contracts to determine if applicable laws, regulations, and policies were being followed.

As a result of our work, we had no findings related to contracts. However, other minor weaknesses came to our attention which have been reported to management in a separate letter

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DIVISION OF REAL PROPERTY AND CAPITAL PROJECTS MANAGEMENT

Our objectives in reviewing the procedures used by this division were to determine whether

- Properly completed deeds were on file for state-owned real property and property leased by the state;
- the documentation on state-owned real property complied with the applicable laws and regulations;
- there was adequate security over the real property files.

We interviewed key personnel about the procedures being used and compared these procedures to the applicable laws and regulations. We tested a sample of real property parcels to determine if there were properly completed deeds on file. We tested a sample of real property purchases to determine if there was adequate appraisal documentation on file. We tested a sample of real property disposals to determine if there was a properly executed quit claim deed on file and if the property was removed from the land value report timely.

As a result of our work, we had no findings related this division.

CONTINGENT REVENUE

Our objectives in reviewing contingent revenue were to determine whether

- transactions related to contingent revenue were proper;
- debit balances could be adequately explained and were proper;
- interest on the balance was transferred in a timely manner to the account,
- the index used to increase the balance of the fund's principal to offset the effects of inflation was proper.

We obtained a schedule of contingent revenue which showed the beginning balance, all activity affecting the account, and the ending balance. All pertinent balances and transactions were tested for propriety.

As a result of our work, we had no findings related to contingent revenue; however, other minor weaknesses came to our attention which have been reported to management in a separate letter.

DEPARTMENT OF FINANCE AND ADMINISTRATION POLICY 20, "RECORDING OF FEDERAL GRANT EXPENDITURES AND REVENUES"

Department of Finance and Administration Policy 20 requires that state departments whose financial records are maintained on the State of Tennessee Accounting and Reporting System (STARS) fully utilize the STARS Grant Module to record the receipt and expenditure of all federal funds. Our testwork focused on whether

- appropriate grant information was entered into the STARS Grant Control Table upon notification of the grant award, and related revenue and expenditure transactions were coded with the proper grant codes;
- appropriate payroll costs were reallocated to federal programs within 30 days of each month-end using an authorized redistribution method;
- the department made drawdowns at least weekly using the applicable STARS reports;
- the department had negotiated an appropriate indirect cost recovery plan, and indirect costs were included in drawdowns; and

- the department utilized the appropriate STARS reports as bases for preparing the Schedules of Federal Financial Assistance and reports submitted to the federal government.

We interviewed key personnel to gain an understanding of the department's procedures and controls concerning Policy Statement 20. As a result of this testwork, we drafted the following finding. Other minor weaknesses came to our attention which have been reported to management in a separate letter.

12. The department has not complied with important aspects of the state's grants accounting policy

Finding

The Department of Finance and Administration's Policy 20, "Recording of Federal Grant Expenditures and Revenues" lists the procedures that must be followed to properly account for federal funds. In several areas, the department failed to follow these procedures.

a. Section 20-02-202 of the policy states, "All grant awards must be recorded at the time that grant award notification is received from the Federal government." Six of ten grant awards tested (60%) were not entered into the grant control module timely. The lag time ranged from two to 21 months.

b. Section 20-02-204 of the policy states, "Federal drawdowns must be made utilizing the STARS (State of Tennessee Accounting and Reporting System) grant module …Unless disallowed by Federal law or grant agreement, all drawdowns must be performed at least weekly." Three of 25 drawdowns tested (12%) were not made within one week of the previous draw. Six of 25 drawdowns tested (24%) contained draws that were not made within five working days of the date to draw shown on the STARS daily drawdown report.

c. Section 20-02-207 of the policy states, "Status reports to the Federal government must be prepared utilizing the STARS grants module." For five of 12 applicable grants tested (41.7%), the fourth quarter disbursements totals on the STARS grant module reports were different from the amounts shown on the quarterly reports sent to the federal government. Reconciliations of the differences were not performed.

d. Section 20-02-205 of the policy states, "Where allowed under Federal statute and grant regulations, agencies must negotiate an indirect cost recovery plan." For five of seven applicable grants tested (71.4%), indirect costs were not charged to the grants, although this was permitted.

Not following these procedures increases the probability that the state will either incur questioned costs or not receive the federal funds to which it was entitled in a timely manner.

Recommendation

The Director of the Office of Business and Finance should ensure that all personnel involved with grants accounting are aware of the policy's requirements and ensure they are followed.

Management's Comment

We concur. As appropriate, additional training will be provide on Policy 20 and supervisory staff will monitor compliance.

DEVELOPMENTAL CENTERS AND OFFICES OF COMMUNITY SERVICES

Our objective in reviewing procedures at these centers was to determine whether

- Adequate controls were in place to ensure that the centers properly administered and accounted for resident trust funds,
- controls over the operation of the commissary at the centers were adequate,
- controls over expenditures were adequate and in compliance with state regulations,
- controls over inventory were adequate, and
- the department had fully complied with Executive Orders 9 and 10.

We interviewed key personnel about the procedures used and compared these procedures to the applicable laws and regulations. We performed the testwork on trust fund balances and account withdrawals, commissary operating reports, access to the state's accounting and purchasing computer systems, center expenditures, inventory records, payroll, and equipment at Clover Bottom.

As a result of this testwork, we drafted the following findings. In addition, other minor weaknesses came to our attention which have been reported to management in a separate letter.

13. The department has entered into an interdepartmental agreement with DMHMR for administrative support for the Mental Retardation Services now in Finance and Administration and therefore has not fully complied with Executive Orders 9 and 10

Finding

As stated in the prior audit, the Department of Finance and Administration has not fully complied with two executive orders concerning the state's developmental centers. When the federal courts demanded improvements at Arlington Developmental Center, the Governor transferred (via Executive Order 9, February 7, 1996) management and operation of the center from the Department of Mental Health and Mental Retardation (DMHMR) to the Department of Finance and Administration. (The West Tennessee Office of Community Services in DMHMR was also transferred to Finance and Administration at that time.) Executive Order 10, issued October 14, 1996, transferred to the department the remainder of the centers and their associated offices of community services: Clover Bottom Developmental Center, Greene Valley Developmental Center, Nat T. Winston Developmental Center, and the Middle and East Tennessee Offices of Community Services.

Although the orders transferred all related functions (e.g., fiscal, personnel, and property and equipment), the operations and management of the developmental centers and the offices did not significantly change after the executive orders were issued. A change was made in how management decisions regarding the developmental centers are made and who makes them. The Deputy Commissioner for DMHMR reports to the Commissioner of Finance and Administration for policy matters regarding Clover Bottom Developmental Center, Greene Valley Developmental Center, Nat T. Winston Developmental Center, and the Middle and East Tennessee Offices of Community Services. For Arlington and the West Tennessee Office of Community Services, the Department of Finance and Administration has a contract with an individual to oversee the operations. That individual reports to the Commissioner of Finance and Administration.

Management concurred with the prior finding and stated that it was taking steps to comply with the Executive Orders. These included amending the FY 1998-1999 Appropriations Bill to include the Mental Retardation Services Division as part of the Department of Finance and Administration and entering into an agreement with DMHMR for administrative support and the administration of the Maintenance and Equipment appropriation for Mental Retardation Services. The 1998-1999 Appropriations Bill was amended to move the DMHMR to the Department of Finance and Administration as management stated they would in their prior comments. In addition, the Department of Finance and Administration entered into an agreement with DMHMR for administrative support and administration of the Maintenance and Equipment appropriation for Mental Retardation Services. However, the legality of this interdepartmental agreement was questioned. A May 13, 1999, response from the Attorney General and Reporter to a request for informal advice concerning this interdepartmental agreement states,

> Based on the facts available to this Office, the Agreement is not clearly authorized under statutes permitting assistance and cooperative work between executive departments. In any case, the

> parties to the Agreement apparently concluded that the Executive Orders transferred certain Central Office functions of MHMR to F and A, but that the transfer was inadvertent. The agreement is intended to address that problem. It is not clear whether two executive departments may correct an executive order by an interdepartmental agreement. This problem is probably more appropriately addressed by an executive order clarifying the earlier orders.

In addition, the Attorney General's response relied on Section 4-4-109, *Tennessee Code Annotated*, as providing authority for agreements between executive departments. Section 4-4-109, *Tennessee Code Annotated*, allows agencies to obtain from other departments:

- services of experts;
- use of any special apparatus from another department; or
- any work the department is not equipped to do.

The response states,

> Many of the services performed under the Agreement are basic administrative services. It is possible, however, that MHMR personnel have particular expertise in these areas as they relate to the developmental centers.

The services Finance and Administration has obtained from DMHMR through the interdepartmental agreement do not appear to meet any of these requirements. The Department of Finance and Administration has a fiscal office that could handle the administrative functions of the Developmental Centers. This may require additional staff, but the Executive Orders allow for staff indirectly performing functions for the Developmental Centers to be transferred to the Department of Finance and Administration. Therefore, it would be appropriate for Finance and Administration to obtain some staff from DMHMR to perform administrative duties for the Developmental Centers. The response also states,

> Even if it could be argued that the agreement is technically authorized under Tenn. Code Ann. Section 4-4-109 …, it is not clear that two departments are authorized to reverse an executive order by an interdepartmental agreement.

Part 3 of Executive Order 9 and part 2 of Executive Order 10 state, "Said Commissioner shall perform all duties and have the same authority and responsibility" with respect to the developmental centers and the offices "as the Commissioner has with other divisions or areas under the jurisdiction and control of the Department of Finance and Administration." However, the department has not taken over any fiscal responsibilities. The superintendents at the centers still approve financial transactions as the DMHMR department head with very limited oversight and review by DMHMR central office fiscal staff (See finding 3). Neither the commissioner nor the fiscal officer of DMHMR approves these transactions. The DMHMR central office also does some payroll transactions for the developmental centers and continues to process travel claims, payroll, etc., for all staff at the offices of community services. The Department of Finance and Administration, Division of Accounts, Pre-Audit Section, continues to process transactions for the developmental centers and the offices of community services even though these transactions are approved by DMHMR personnel. No authorized official of the Department of Finance and Administration approves these transactions as directed by the executive orders.

The employees of DMHMR no longer have the legal authority to approve the expenditure of funds appropriated to the developmental centers and the offices of community services. The executive orders transferred the authority to approve the expenditure of funds to the Department of Finance and Administration, but the department has not exercised this authority and assumed this responsibility.

Recommendation

The Commissioner of Finance and Administration should ensure that the Department of Finance and Administration fully complies with Executive Orders 9 and 10 until a new executive order is issued to clarify the previous orders**.** All transactions should be consistent with applicable state laws and initiated and approved only by those officials having the requisite legal authority and responsibility. The department should comply with Section 4-4-109, *Tennessee Code Annotated*, when obtaining services from other state departments.

Management's Comment

We do not concur. As stated in our comments to the prior audit, Executive Orders 9 and 10 were not intended to transfer the MHMR Central Office to F&A. Additionally, we feel that MHMR Central office staff is more equipped to handle MR administrative duties because of their experience working with developmental centers for many years. To try and split this staff between MH and F&A would be detrimental to both organizations and provide service of a lessor quality. We feel we are in compliance with Section 4-4-109, *Tennessee Code Annotated*.

However, we are exploring the option of an executive order to clarify the earlier orders.

14. Recordkeeping and security for equipment are inadequate

Finding

Clover Bottom Development Center (CBDC) does not have adequate controls over equipment, does not maintain accurate property records, and has failed to comply with several State of Tennessee and CBDC policies and procedures regarding property and equipment. A large amount of property is unaccounted for and missing.

CBDC has not maintained a complete and accurate inventory of its property and equipment on the Property of the State of Tennessee (POST) system, as evidenced by the following problems:

- Nineteen of 60 property items selected (31.7%) from the POST property listing could not be located. The missing items included desktop and laptop computers, an electrocardiograph, several Clover Bottom meal carts, and specialized patient rehabilitation and communication devices. Personnel stated that three of the missing items were acquired for individual residents who took the items when they were discharged. These transfers were apparently not documented. The Property Management System Policy and Procedures Manual section 6(A) states, "When a resident is discharged from CBDC to a community setting or to his/her home, all state purchased equipment or sensitive equipment that is necessary to the client's care and training after discharge shall be properly identified for transfer of responsibility." In addition, Clover Bottom personnel stated that one missing item was traded for another device; but documentation of the trade was not available. The POST User Manual, Appendix E, states,

  > "An explanation of the trade-in must be submitted to the Department of General Services Fiscal office. This memorandum must outline the proposed transaction supplying the state tag number, exact location of the item, and the name of the individual that could be contacted for additional information...If an item has been approved for trade-in..., the agency must signify in writing detailing tag number, vendor name, and the date the item was removed."

- The testwork focused on the higher cost items on the POST listing; however, additional evidence indicates that a serious problem exists with lower cost items as well. The property officer informed the assistant superintendent by memorandum on June 4, 1998, that 63 television sets and 29 video cassette recorders (VCRs) were missing. In addition, an exception report from the Department of General Services, dated May 12, 1998, disclosed that the property officer could not locate 389 items.

- For 4 of 43 items tested (9.3%), the state tag number on the item did not match the number recorded in POST. Two items did not have a state tag attached; these items were identified by their serial numbers.

- For 11 of 38 items tested (29%), the serial number on the item did not agree with the serial number recorded in POST.

In addition, CBDC's internal controls over property and equipment are inadequate as described below:

- There is no written assignment of responsibility for property and equipment in non-residential buildings. When an item is missing, department personnel have not been instructed as to who should report this information to the property officer and the director of safety and security. As a result, missing/stolen items may not be reported timely, or at all, and may remain on POST.
- Property items are moved on the basis of verbal authority. The Property Management System Policy and Procedures Manual, sections 4(A), (B), and (C) state the following concerning a move of equipment within the facility,"...a list will be generated which will be used to make the move as well as for the information needed for the Property personnel. After the move is completed, the Property personnel will use the same document to make the necessary changes on the computer." The Property Officer does not regularly create or maintain such lists when moving items.
- Annual inventories of property have not been performed. The property officer did perform a property count during April-May 1998, but had no property listing to use as a basis for performing a correct inventory. Property items continued to be moved during the course of performing the count. The property officer stated that the last inventory performed before 1998 was in 1995. However, the property officer could not produce any documentation of an inventory ever being performed prior to the count carried out in April-May 1998. The Property Management System Policy and Procedures Manual section 4(D) states, "At least annually, the Property Officer will conduct an inventory of all the areas at CBDC...During this time period, there will be no movement of any property."
- The missing televisions and VCRs noted above were not properly reported to the Comptroller of the Treasury and local police authorities. Section 8-19-501, *Tennessee Code Annotated*, requires any official of any Tennessee agency knowing of missing state property or of property that has been removed in an unauthorized fashion to report these circumstances to the Comptroller of the Treasury. Police reports were on file for only 7 of the items discovered missing during the audit period and the Comptroller of the Treasury was not notified of any of these missing items.
- The property officer is responsible for updating the equipment inventory in POST. This person also performs the physical inventory of equipment, which means that this person could remove equipment and continue to show the equipment as being on hand.

If equipment records are not kept up-to-date and duties are not adequately segregated, the center will find it increasingly difficult to know what equipment it has and what needs to be purchased or surplused. In addition, unauthorized removal of equipment would become increasingly difficult to detect.

Recommendation

The property officer should promptly update POST as changes in the center's property and equipment occur. Responsibility for each equipment item, whether organized by building, room, or individual, should be assigned in written form and effectively communicated to employees.

Detailed written procedures for reporting missing items should be developed and distributed to all employees. The property management system policies and procedures for documenting the movement of items should be followed, and this documentation should be kept on file. A policies and procedures manual for the physical security of property items should be developed.

Annual physical inventories should be performed in accordance with existing Department of General Services and Clover Bottom Developmental Center policies and procedures. Written procedures should be developed to ensure that property transferred to discharged patients is appropriate and fully documented, and that such transfers are promptly reported to the property officer in order to update the POST system. Missing items should be promptly reported to the police and the Comptroller of the Treasury, and documentation of this report should be retained. Full police reports of suspected stolen items should also be made whenever possible and copies of the reports kept on file.

Existing policies on state property tags should be followed and incorrect or missing tags should be replaced. Tag numbers, location, etc., should be accurately listed on the POST system. Responsibility for removing items from the POST system should be assigned to personnel not involved with the annual inventory.

Management's Comment

We concur. During the period covered by this audit, Clover Bottom Development Center (CBDC) had just come under a new superintendent and certain of the controls in this area had not yet been implemented. Since June 30, 1998, the new superintendent has instituted the following changes:

- A new program has been placed into effect to inventory and document items that go out into the community when clients/residents leave CBDC.
- CBDC now has procedures in place so that Security is notified of missing property: they will notify CBDC Fiscal and other proper authorities and the Fiscal section will in turn notify the Department's Fiscal Officer.

- CBDC has added new personnel and they have been assigned to work with the property officer to ensure control over changes in equipment status and reporting of such transactions to proper state departments.
- By adding new personnel, CBDC has created a back-up system whereby a second person is now able to review property tagging information and to perform the physical inventory count.
- Department Heads are now responsible for the equipment in their respective areas.
- Written request/documentation is now required before movement of anything from one location to another. This documentation includes the serial number and other pertinent information.
- Appropriate procedures are being added to the Security Manual.
- Equipment is now inventoried on an annual basis and logged into a computer system for tracking/inventory purposes.

15. <u>Internal controls over inventory were inadequate</u>

Finding

Clover Bottom Developmental Center did not segregate the duties of ordering, receiving, and updating supply inventory records. The medical supply manager had the following responsibilities:

- Preparing purchase orders
- Receiving inventory items
- Updating inventory records
- Adjusting inventory records and disposing of items without review or approval by a supervisor

No one independent of the medical supply manager reviews the inventory activity log or reconciles the ending balance to the receipts, issues, and disposals. Additionally, no individual was assigned as a back up for the medical supply manager, so that records could be updated during the manager's absence. All adjustments to the inventory records were not documented, resulting in differences between the perpetual records and physical count of items.

For seven of 60 inventory items tested (12%), the quantity of items on the perpetual records did not agree to the actual number of items on hand. The result of this could be that the proper level of inventory items would not be maintained because receipts and issues of items were not properly posted to the inventory records or that theft of inventory could occur and go undetected. However, due to the lack of internal controls, management has no way to determine if the differences are due to theft or poor recordkeeping.

When duties are not properly segregated and records are not updated timely, the probability increases that errors or irregularities could occur and go undetected.

Recommendation

The Superintendent should implement effective internal controls over inventory. Effective internal controls should include the following procedures:

- Someone other than the medical supply manager should receive the medical supplies.
- The fiscal director should approve in writing any disposal of medical supplies.
- Each month, the fiscal director should review the medical supplies activity log and reconcile the ending balance to the receipts, issues, and disposals.
- A listing of personnel who could substitute for the manager in the event of an absence should be developed.

Management's Comment

We concur. Central Medical is a one person operation. The Medical Supply Manager did prepare purchase orders and log the receipts into the computer. All purchase orders, however, were reviewed and signed by three other levels of management. Items were first received and signed for by warehouse personnel before they were sent to Central Medical. Adjustments to the inventory records were made using an R-4 adjustment form. This form must be signed by the Chief Accountant before an adjustment is processed. At this time, there are plans to add an additional person to the Central Medical Supply unit. This person will assist in maintaining the perpetual inventory records so that errors do not occur and provide back-up for the Medical Supply Manager as needed. The Fiscal Director will reconcile medical supplies receipts, issues and disposal monthly.

16. Fiscal controls at Clover Bottom and Arlington Developmental Centers were inadequate

Finding

Clover Bottom

Cash-receipting duties at Clover Bottom Developmental Center were not segregated. The Accountant II performed the following duties:

- Receives checks and prepares the receipt
- Posts deposits to the general ledger
- Prepares the bank deposit slips
- Makes the bank deposits
- Reconciles the bank statements
- Reconciles the deposits with the subsidiary ledgers with no secondary or supervisory review.

Section 9-7, of the Policies and Procedures Manual for Middle Tennessee Mental Health Institute, which apply also to Clover Bottom states, "In order to maintain proper internal control, the three functions of receiving money, depositing it, and posting the ledger accounts, must be kept separate and performed by different employees." If duties are not adequately segregated, errors or irregularities may occur and not be detected.

Arlington

Six of 29 persons who had access to the State of Tennessee Accounting and Reporting System (STARS) at the end of the fiscal year were no longer employees of the developmental center. Two of 11 persons who had access to the State Employees Information System (SEIS) had duties that did not require access to SEIS.

Not promptly canceling or controlling access to these important systems increases the possibility of unauthorized changes and decreases assurances of the systems' integrity.

Recommendation

Clover Bottom

The Fiscal Director at Clover Bottom Developmental Center should review the duties assigned to each employee and design appropriate controls to ensure that the person who records the receipt of checks is different from the person who prepares the bank deposit and makes the deposit. Also, an employee independent of these other functions should perform the monthly bank reconciliation.

Arlington

The Fiscal Director should review the listing of personnel who have access to STARS and SEIS and ensure that any improper access to the systems is immediately terminated. As part of the termination process, the Fiscal Director should ensure that all access is cancelled as of the end of the last day of work.

Management's Comment

Clover Bottom

We concur. During the period covered by this audit, the Fiscal section was severely hampered by a shortage of staff. Since that time, duties of logging checks received through the mail has been assigned to a someone other than the Accountant II. The Chief Accountant is now reviewing the reconciliations. The Accountant II continues to write receipts, but another employee prepares the bank deposit and a third employee takes the deposit to the bank. A fourth employee then enters the transaction into STARS. All Requests for Funds are now approved by Fiscal/Reimbursement before any money is released.

Arlington

We concur. Canceling and controlling access to STARS and SEIS has been enhanced since the period of the audit.

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Department of Finance and Administration filed its report with the Department of Audit on October 28, 1998. A follow-up of all prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the Department of Finance and Administration has corrected previous audit findings concerning controls over security for the Tennessee Insurance System, and the dividing of purchases at Arlington Developmental Center to circumvent state purchasing policies and procedures.

REPEATED AUDIT FINDINGS

The prior audit report also contained findings concerning The Tennessee Insurance System and the State of Tennessee Accounting and Reporting System (STARS) not reconciling, and the failure of the department to satisfactorily comply with Executive Orders 9 and 10.

These findings have not been resolved and are repeated in the applicable sections of this report.

OBSERVATIONS AND COMMENTS

TITLE VI OF THE CIVIL RIGHTS ACT OF 1964

Tennessee Code Annotated, Section 4-21-901, requires each state governmental entity subject to the requirements of Title VI of the Civil Rights Act of 1964 to submit an annual Title VI compliance report and implementation plan to the Department of Audit by June 30, 1994, and each June 30 thereafter. For the year ending June 30, 1998, the Department of Finance and Administration filed its compliance report and implementation plan on July 2, 1998.

Title VI of the Civil Rights Act of 1964 is a federal law. The act requires all state agencies receiving federal money to develop and implement plans to ensure that no person shall, on the grounds of race, color, or origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal funds.

The State Planning Office in the Executive Department was assigned the responsibility of serving as the monitoring agency for Title VI compliance, and copies of the required reports were filed with the State Planning Office for evaluation and comment. However, the State Planning Office has been abolished. The Office of the Governor has not designated a new monitoring agency for the Executive Branch.

A summary of the dates state agencies filed their annual Title VI compliance reports and implementation plans is presented in the special report, *Submission of Title VI Implementation Plans,* issued annually by the Comptroller of the Treasury.

APPENDIX

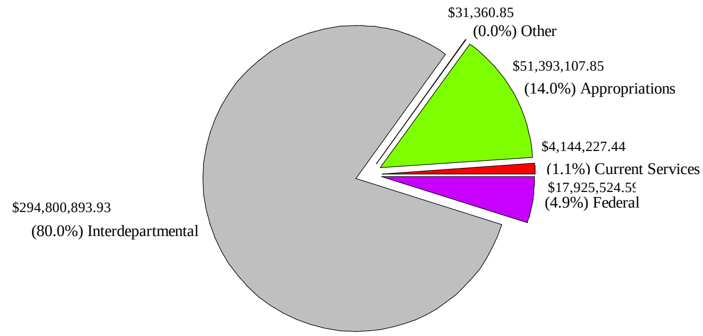
DIVISIONS AND ALLOTMENT CODES

Department of Finance and Administration divisions and allotment codes:

317.01	Executive Offices
317.02	Division of Budget
317.03	Office for Information Resources
317.04	Administrative Services
317.05	Division of Accounts
317.06	Criminal Justice Programs
317.07	Division of Resource Development and Support
317.10	Capital Projects and Real Property Management
317.11	Commission on National and Community Services
317.14	Office of Furniture Distribution
317.30	Management Information Systems Fund
317.86	TIS Insurance System
317.97	Telephone Billing
339.21	Mental Retardation - Administration
339.22	Developmental Disabilities Services
339.23	Community Mental Retardation Services
339.24	Regional Offices of Community Services Center
339.25	Arlington Developmental Center
339.26	Clover Bottom Developmental Center
339.27	Greene Valley Developmental Center
339.28	Winston Developmental Center
355.02	State Building Commission
501.01	Facilities Revolving Fund
501.03	Facilities Management
501.04	Facilities Revolving Fund-Capital Projects
501.05	Facilities Revolving Fund-Debt Service

Departmental Funding Sources

Fiscal Year Ended June 30, 1998 (Unaudited)

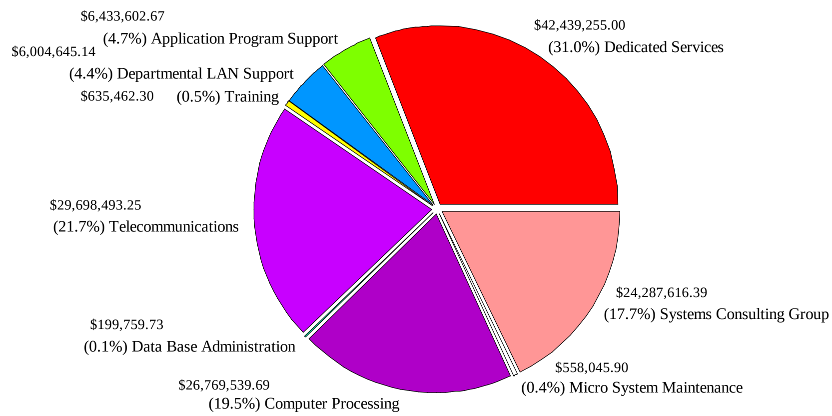


Source: Department of Finance and Administration

Note: OIR and State Building Commission are not included because they are not part of the General Fund

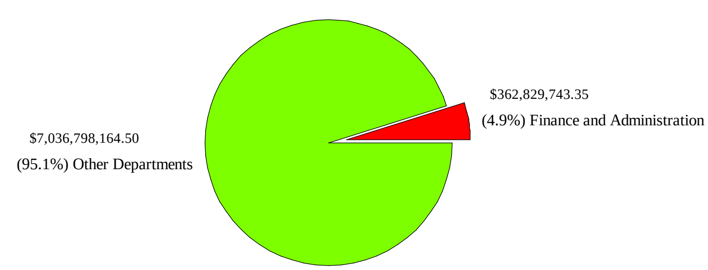
OIR Total Billable Services - - $137,026,420.07

Fiscal Year Ended June 30, 1998 (Unaudited)



Source: Department of Finance and Administration

State of Tennessee General Fund Expenditures



Source: Department of Finance and Administration